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Crown Corporations and CBCA

(Discussion paper no. 23)

Office of the
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CROWN CORPORATIONS
AND CBCA

By Peter King

March 1984

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Table of Contents

Suitability of the Canada Business Corporations Act for Incorporating Crown Corporations

INTRODUCTION

The lengthy struggles between Parliament and the British Crown during the seventeenth century established the fundamental principle that the Crown shall have no supply without the approval of Parliament. While this principle established that the Crown's revenues are voted by Parliament, the Crown's prerogative to spend those revenues for, and only for explicit purposes appears to be less clearly stated. Logic would suggest that if the Crown were to spend its revenues on other than those purposes accepted by Parliament, Parliament could in theory withhold all further funds.

At the time of the British struggles, Parliament was both in law and in practice separate from and a watchdog on the executive Crown. Today, the government has in practice become the Executive Crown and is effectively in control of Parliament. But, as part of Parliament, the government is expected to continue its traditional role so that the distinction between the Crown's actions and Parliament's independent consideration of the extent of support for such action has lessened. On the one hand, the Government in its role as the Crown seeks freedom of action and to control its source of supply while, on the other hand, in its role as a part of Parliament, it is expected to comply with the traditionally conflicting role of controlling the Crown. Of necessity, its role as the Executive Crown predicates that control of (i.e., obtaining) supply must take precedence over its role as a control (i.e., watchdog) of the Crown. The

government achieves its control of supply mainly by overriding attempts by the opposition to seize control. In this context, it must be borne in mind that, by tradition, a defeat in Parliament on a 'money bill' is normally considered a matter of confidence and the government would be expected to resign. To the extent that the government in seeking supply fails to provide information by which Parliament can decide whether the Crown's request is reasonable, the government is treading close to the principles which Charles I followed and which precipitated the British Parliamentary Wars.

The Federal Government has established several corporations using the Canada Business Corporations Act (CBCA) or the Ontario Business Corporations Act (OBCA) which give these corporations very flexible powers. Parliament has approved supply for several of these entities without knowing, being able to find out or having any control over the purposes for which they were created. Unlike for Crown corporations and government agencies or departments for which Parliament has passed enabling legislation, the powers and purposes of these corporations are set by the government acting as the Crown. Accordingly, these corporations could be empowered to carry out government activities without the knowledge or against the wishes of Parliament even if these could be determined. If, in such a case, Parliament grants supply without knowledge of the purposes for which the supply is used, it is effectively impossible for Parliament to assert any control until the next request for supply is presented, unless the corporations were to act outside their legislated powers. However, it should be noted that for the corporations incorporated under CBCA there are no legislated powers since the powers can be changed at will by the Shareholders simply through an administrative process.

SCOPE

This paper is restricted to discussion only of Crown corporations which have been incorporated under the Canada or Ontario Business Corporations Acts, the shares of which are wholly owned by the Crown.

Discussion of Crown corporations incorporated under a Special Act of Parliament is excluded on the grounds that Parliament had the opportunity to consider the factors raised in this paper and has resolved them as reflected in the Special Act.

In the cases discussed herein, Parliament had no such opportunity and therefore was either ignorant of the situation or chose not to consider the matter. Implicitly, if the latter applied, Parliament must assume that the government is achieving public purposes while combining entrepreneurial flexibility with public accountability. The paper discusses, in effect, whether the assumption is valid.

EXECUTIVE SUMMARY

Conceptually, Crown corporations incorporated under the Canada Business Corporation Act (CBCA) are designed to permit the achievement of government objectives by combining entrepreneurial flexibility with the requirements of public accountability. The paper analyses whether the use of the CBCA is a suitable vehicle to achieve these purposes.

The conclusion is that the CBCA is not a suitable vehicle because the requirements of public accountability preclude entrepreneurial flexibility as traditionally practiced. Specifically:

- If responsible government and public accountability are to exist for Crown corporations, Parliament - to which the government is accountable - and not the government itself, must have control over the creation, the establishment of and funding arrangements for powers of such corporations. In the case of the Crown corporations presently incorporated under the CBCA, this has not happened.

- The joining of entrepreneurial flexibility with public purpose and accountability is complex. The implications of the complexity have not been adequately considered.

- The CBCA regulates the activities of an otherwise unrestricted business entity and reflects the relationship of a corporation to its shareholders and its creditors, basically relying on long-established market forces to provide additional disciplinary influences. Operation under such conditions is generally understood to mean entrepreneurial flexibility. On the other hand, if public accountability as presently established by Parliament, is to be maintained, Crown corporations must comply with the Financial Administration Act (FAA). The FAA, however, contains restrictions, which in effect limit

entrepreneural flexibility and total exemption from which can only be obtained by legislation.

- The use of a unanimous shareholders agreement is logical in the case of a private sector corporation because it does not disturb market influences. The agreement is not appropriate in the case of a Crown corporation because, while possibly ensuring a degree of public accountability, it displaces market influences and so distorts entrepreneurial flexibility. In effect, it subjects the corporation to the direct influences of government wishes.

- There is insufficient commonality or similarity between corporations complying with either CBCA or the FAA alone to use business criteria to provide assurance that both public accountability is respected and entrepeneurial flexibility exists.

- The present practice of incorporating Crown corporations under the CBCA to achieve public purposes introduces a contradiction. Entrepreneurial flexibility exists for a corporation incorporated under the CBCA because the corporation has the freedom to operate generally without legislative restraints. To achieve public accountability requires either specific legislation for the corporation, or adding the corporation to a schedule of the FAA. Compliance with the FAA entails restrictions which limit freedom to operate. Exemption from those restrictions can only be obtained by legislation. If total freedom is granted, simply by

> not applying the FAA to a Crown corporation, public accountability disappears. Some form of legislation specific to each corporation is required - but the principle of incorporating a corporation under the CBCA is that such specific legislation can be avoided.

Finally, the paper suggests some appropriate subjects for inclusion of legislation for Crown Corporations were to be drafted.

THE PRACTICE

A number of federally owned Crown corporations exist which have been incorporated under the authority of the Canada or the Ontario Business Corporations Act. Of these, eighteen have been added to the schedules of the Financial Administration Act. Under this Act, each corporation by law must report through an appropriate Minister to Parliament.

As noted in the Public Accounts of Canada, the 18 Crown corporations account for $2.431 billion in expenditures. These corporations constitute almost half of a package of corporations which, as the Auditor General in his 1982 and 1983 Reports indicated, account for almost 6% of the total annual expenditure of the Government of Canada.

Seven of the eighteen Crown corporations operate under the terms of an agreement with a Minister, approved only by Order in Council, which establishes the purposes, mandates, limitations on powers and directives with which the corporations are to comply. The total operating and capital costs for these corporations by the end of their present mandates, is expected to exceed $750 million.

Six of these seven Crown corporations although required to do so, failed to comply with some of statutory obligations of both the FAA and its regulations and the CBCA and with directives of the Governor in Council and the Treasury Board.

Parliamentary approval for supply to these seven corporations for which no prior Parliamentary approval existed, was obtained by inclusion of vote wording in the Estimates even though the speaker of the House ruled that vote wording cannot be used to gain Parliamentary approval for programs for which no previous legislation exists. The vote wording in these cases was merely "Payments to the XXX Corporation" and in one case the additional wording of "and the right to retain and spend revenues received." Where a corporation's annual report was tabled, such tabling usually took place after the debate on the Estimates was over. Thus Parliament did not have the opportunity to consider these particular items in the estimates process.

Several of these corporations have, or have had, public servants on their Boards of Directors or even as officers of the corporation. As directors or officers, the public servants have statutory obligations to the corporations. At the same time, their role as public servants requires them to advise and inform their Minister. At times, these roles can conflict and no clear direction has been given as to where the priority lies. Generally, public servants when requested for advice by the Minister, have given priority to their Ministers. In the case of one corporation Cabinet approval has been given to the corporation's corporate plan which states the principle that priority should be given to Corporate responsibility. Nonetheless, even if not requested by a Minister, public servants have a fundamental responsibility to provide objective advice to Ministers to the limits of their knowledge where public funds are being expended. Thus, many of the omissions noted earlier could have been avoided had public servants fulfilled only these duties.

Possibly as a direct consequence of the failures to comply with the various obligations and directives, the Crown has, as reported in the 1983 Auditor General's report, unknowingly assumed liabilities of undetermined magnitudes. Furthermore, failure to comply with the requirements of the Financial Administration Act has left Parliament without information and thus with no possibility of holding the appropriate Minister accountable. (note: by the end of 1983, "the appropriate Ministers" for six of the seven corporations, as required by the Financial Administration Act, had not all been appointed, even though commitments have been made towards the programs.)

The Financial Administration Act requires ALL corporations subject to the Act to table their capital budgets and annual reports. However, if a corporation is not added to a schedule of the Act, its budget and annual report do not have to be tabled. This, and the inclusion in Appropriations Acts of wording so general as to convey no information, for these corporations has effectively hindered parliamentarians from even asking meaningful questions. As a result, Parliament in these cases has been denied the opportunity to carry out its traditional role of challenging the Crown over all the Crown's proposed expenditures.

In the absence of information and Parliament's inability to challenge the Crown over these items of expenditure, accountability for the expenditure of these public funds is at best sketchy, a situation exarcerbated if the veil of commercial confidentiality is also dropped over any corporation.

In 1966, the Auditor General raised the issue of the incorporation of a crown corporation by three public servants and without formal parliamentary knowledge. Later, and in the absence of a clear mandate for the company, an Order in Council gave approval to dissolve the company, however, for operational reasons the Order was withdrawn. Instead, the company continued for reasons that were described by a departmental official , perhaps prophetically, as follows:

> "...The creation of subsidiaries to the corporation is strictly based on convenience. Since the holding company has been recognized by Parliament through appropriation votes, any new corporation can be attached to it instead of going through Parliament to have its incorporation approved or existence recognized."
>
> In 1960, Glassco reported:
>
> ...(There are) "organizations ... which in essence involve the appointment, by the government of a board of trustees to whom is delegated the management of a public undertaking, within limits of public policy as defined in broad terms by Parliament and the government."
>
> "All these activities of government could, if political circumstances required it, be carried on under the departmental forms. The nature of an activity, by itself, does not dictate the ministerial role. Manufacturing operations, transportation services lending and insuring activities and all the rest could be managed by departmental organizations; in fact activities of these kinds can be found today within various departments...
>
> In the opinion of (the Glassco) Commissioners, a board of management should be only used when responsibility for the conduct of the program can be fully delegated to an independent group, and financial viability is ensured by suitable capitalization and an adequate revenue basis."

Glassco's observations were repeated when, almost 20 years later, the Lambert Commission discussed the role of Crown corporations at length. Lambert pointed out that Canadian public enterprises in corporate form operate in parallel and normally in competition with private ventures. Like Glassco,

Lambert concluded that when governments become involved in market operations a "sensible method of achieving devolution is to entrust such tasks to a corporate board of directors." However, Lambert went on to say that while "governments seek to take advantage of the autonomy, flexibility and special skills that have made the private sector corporation the successful entrepreneurial instrument it can be "..." the Crown corporation differs from its private sector counterpart in a number of important and inescapable ways. It is an organizational hybrid with relationships with Government and Parliament that are neither clear nor simple and that differ, moreover, in significant ways from the normal relationship of a corporation with its shareholders." Lambert pointed out that by law, directors and officers of all corporations have certain duties and obligations imposed upon them, but in public sector corporations a board of directors not only assumes these same obligations but must contend with a designated minister, other ministers and central agencies, the Cabinet and, ultimately, Parliament.

In his 1982 annual Report, the Auditor General asked whether most Crown-owned corporations were achieving the objectives set for them. He raised the issue because he stated that adequate information to judge them was not always received by Government. Furthermore, the information received by Parliament was totally unsatisfactory. He went on to explain that while increasingly, the corporate form was being chosen by Government to achieve public policy objectives the accountability framework had not evolved at the same rate. It was an issue he raised again in 1983.

Clearly, therefore, these are elements of confusion. The federal government has created corporate entities to achieve public purposes but has

caused question to be raised about the propriety and effectiveness of so doing. It is worthwhile, then, to examine whether the corporate form as established under the CBCA and made subject to the FAA can meet the expectations of the government in achieving public purposes and of Parliament in maintaining public accountability. The point of departure for this examination will be the underlying philosophy advanced by the Government in Parliament for the using the corporate form.

THE PHILOSOPHY

The philosophy of the government in creating Crown corporations was expressed in a House of Commons debate on March 23, 1973 both by the Minister of Transport and the President of the Treasury Board:

The Minister of Transport argued:

> "The Crown corporations are created ... because ... the state felt it had to set up an institute to safeguard the interest of the public at a time when no private corporation was interested in establishing that institution, and the nature or purpose of that institution was so closely related to public interest that we could not leave that institution in private hands."

The President of the Treasury Board stated:

> "(The creation of a Crown corporation is justified when) the private sector neither had the resources nor the willingness to do this, so the stimulus was provided and the seeds were sown by the government through the agency of a Crown corporation..."

Lord Morrison of Lambeth in the British House offered this definition of a Crown corporation:

> "If we establish the public corporation, it must be for certain reasons. What are they? They are that we seek to combine the principle of public accountability, of a consciousness on the part of the undertaking that it is working for the national and not for sectional interests, with the liveliness, initiative and a considerable degree of freedom of a quick moving and progressive business enterprise. Either that is the case for the public corporation, or there is no case at all."

In face of criticism by the Auditor General over several years and comments by Royal Commissions, the government at various times after 1978 introduced into the House of Commons bills to amend the Financial Administration Act. The essence of the policy, as stated by the government in a press release in 1981, was that the government as sole owner of the corporations, has the rights of a sole shareholder under the Canada Business Corporations Act and would exercise these rights through the appropriate Minister. This new regime, the Prime Minister went on to say would provide the framework within which Ministers' responsibilities could be carried out. He left it unclear as to whether 'responsiblities' meant a Minister's accountability to Parliament or his responsibility as the executive of his Department.

As Parliament did not vote on the debate on 23 March, 1973 and has not passed any of the proposed Bills, there has never been a parliamentary decision on the use by the government of Crown corporations which have been incorporated without some form of parliamentary approval. The government, in effect, has been left on its own to pursue a course whereby corporate entities can be created within existing legislation and, by adding the corporations to the schedules of the FAA, maintaining the principle of public accountability. It is seen as a means to meet the case put forward by Lord Morrison.

But can it work in theory or in practice? Can a public or Crown corporation achieve the combination of public accountability and entrepreneural flexibility? If so, can the combination be achieved by incorporating an entity under the CBCA and then turn around and make the corporation subject to the FAA? Or is there possibly a false assumption or a statutory obligation which, when taken into consideration, shows that the combination can NOT be achieved in this particular manner. In effect is the government fitting a square peg into a round hole and in so doing believes it has an adequate or even perfect fit? Since the 1970's such would appear to be the case.

THE THEORY

The examination of whether the concept works in theory will entail discussion of the various elements which surrounds corporations incorporated under CBCA and the requirements of the FAA.

Corporate Form

It would seem from the statements of the government that conceptually there is a 'black box', called a business corporation, which has a well-defined connection to its shareholders. The contents of the black box implicitly are thought to be immaterial, because the only necessary connection stated by which to control the 'black box' is an exchange between the shareholders and the directors of the box. Visually it would be presented thus (Figure I):

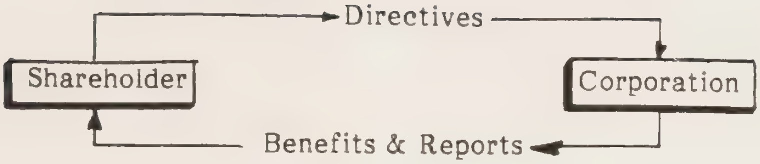

FIG I: Conceptual 'Black Box' relationship

The benefits, in a commercial sense, are of course dividends, increased share value and, upon dissolution, the assets of the corporation. The directives can be actual directives or, more likely, merely the election of directors.

Faced with the complex structure in which a government department finds itself, a simple concept of a black box with one connection is extremely attractive. Unfortunately, the world is not so simple, because the black box has other connections which are likely to be much more important since they influence the activities of the black box to a greater extent.

A commercial corporation certainly is subject to its shareholders' wishes, but such wishes are rarely directives or, if they are directives, they are of a nature which is compatible with the philosophies and practices of the corporation. Of far greater influence on the corporation's activities are such factors as competitors and financing.

A corporation's production and marketing strategies must be dictated by considerations of market demand and competitive pricing. This involves a

complex internal balance which is liable to shift as a result of such unexpected forces as labour demands, consumer attitudes, finance and material costs and availability and the aggressiveness of the competition. The corporation's ability to balance these forces is constrained by the funding it has available to meet its costs.

Funding available to a corporation is almost entirely dictated by market forces. Sales resulting from consumer attitudes represent one source; share offerings evaluated by market investors is another, and debt financing evaluated by the lending institutions' market assessment of the corporation's viability is a third. If all else fails, a corporation can also sell off some of its assets.

In addition to holding the shares of a corporation, a shareholder is a consumer, has access to banks and lending institutions and is interested in only one benefit - "value", which may be in the form of dividends or capital growth. Thus, the relationship of the shareholders to the corporation is complicated by the fact that the shareholders themselves are part of the environment which dictates the corporation's activities. Thus to the example indicated by fugure I, must be added the other connections which affect not only the black box but also the shareholders. There is, if you will, a set of connections between the shareholder and the black box which feed in other directives, and not all the directives are necessarily corroborative. Our figure I begins to look thus (figure II):

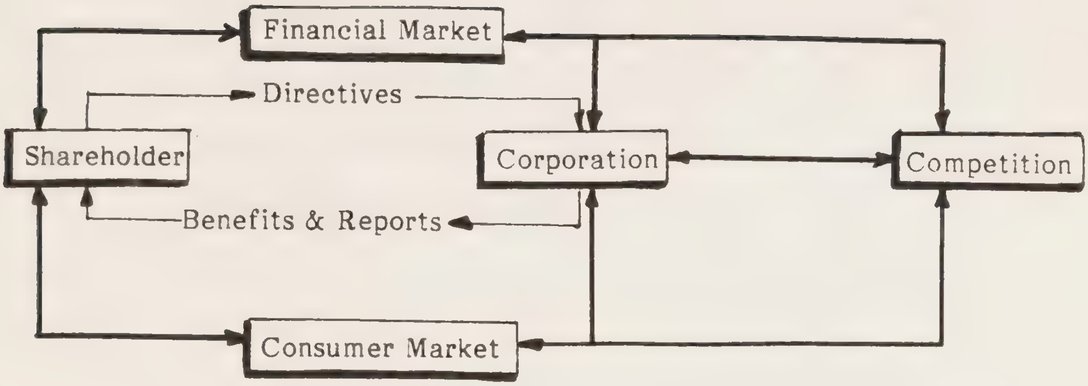

Fig II Realistic relationship corporation to its environment

In the light of the external and possibly conflicting pressures to which it is subject, a corporation hones its objectives to the simplest. The wider the objectives, the more complex the management and the greater the risk of failure. It is a lesson which the great conglomerate enterprises of the 1960's and 1970's learned the hard way.

Advocates of the corporate entity for government purposes suggest that a structure is in place by which a corporation can comply with the two requirements of entrepreneurial flexibility and public accountability. The logic goes somewhat along the following lines:

1) A corporation created under CBCA acts in the normal entrepreneurial manner; thus achieving flexibility.

2) The corporation is added to the schedules of the Financial Administration Act, which means that its budgets must be approved by Ministers and the capital budget laid before

> Parliament; thus achieving control. Its annual report is also tabled in Parliament thus achieving accountability. Further control is maintained by the government holding all the shares and exercising the rights of a shareholder as defined by the CBCA and by appointing public servants as directors.

But the logic is based on faulty assumptions because, as indicated earlier, it fails to take into account fully the separate and different environments under which commercial entities and the public process operate. Furthermore, the logic implies full compliance with all directives, and therefore a control and monitoring system to ensure that all this happens.

Furthermore, no account has been taken of the possibility that the use of the unanimous shareholders agreement in a public accountability environment may destroy the concept of entrepreneurial flexibility. If indeed flexibility is destroyed by such use of the unanimous shareholders agreement, it is possible that the reestablisment of flexibility could only occur if the corporation and/or public servants fail to comply with directives. This is a concept which will be discussed further later in the paper.

Based on the logic advanced above, a presentation of the advocated relationship would appear to be thus (figure III):

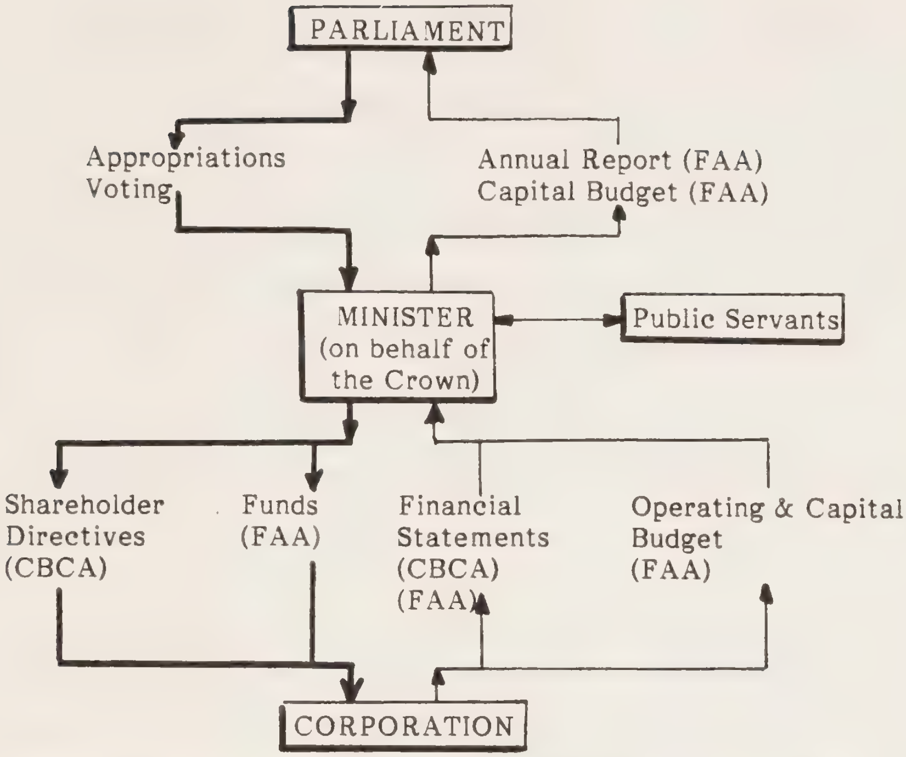

Fig III Advocated relationship of Crown corporation to Minister

ANALYSIS

While there is expediency in creating entities by incorporation under the Canada Business Corporation Act it is worth examining whether in fact the marriage between entrepreneurial flexibility and public accountibility can be made to work by using this instrument. Conceptually, it could work if the influences to which a private sector corporation is subject can influence a Crown corporation to the same extent and if the influences to which a department are subject do not restrict entrepreneurial flexibility. However as shown in Table I there are differences which will be discussed in detail in the following pages.

In examining this question, the nature of the respective influences must be borne in mind. A private sector company is influenced by the subtle interplay of many small diverse elements of the environment of which it is a part. A government department is isolated from most if not all of these influences but instead is influenced by the rigid requirements of public accountability. If the various elements of the two types of influences are sufficiently similar or there is enough commonality, the marriage will work, just as a horse and an ass can be cross-bred to produce a mule. If, however, the influences are too dissimilar or there is insufficient commonality, cross-breeding will not succeed.

The factors which need to be examined are external, because, in the black box concept, the internal 'workings' are irrelevant. Thus the important considerations are the roles of the shareholders, the competition, the consumers, the financial returns and the nature of the interrelationships and communications between them.

The extent of similarity or commonality can be determined by taking these factors as defined or identified by the acts which regulate on the one hand the private sector corporation and on the other the government entity.

Table II

COMPARISON BETWEEN CBCA AND CBCA CROWN CORPORATIONS

	Public Corporation	Crown Corporation
Objectives	1) Profits 2) Growth 3) Survival	1) Public Purposes
Shareholder's Rights	1) Receive Reports 2) Receive Benefits 3) Elect Directors on basis of holding 4) Give direction, but take responsibility	1) Receive Reports 2) Receive all revenues 3) Appoint directors 4) Give direction
Funding	1) Cash Flow 2) Credit w/o shareholder approval Limited only by creditors assessment 3) Commercial practices	1) Appropriations 2) No revenues without parliamentary approval 3) No borrowing without approval by Ministers Borrowing represents liability to Crown 4) Compliance with Government regulations
Accountability	Through Board to shareholders	Through Board to Ministers and Parliament
Shareholders Liability	Limited to shareholders liability	No limitation; cannot be sued
Provincial Taxes	Liable	Immune (possibly)
Sale of Assets	Unrestricted	Restricted by statute
Combines Act	Liable	Immune
Costs of legal proceedings	Liable	Shareholder pays
Security	Must purchase	Shareholder assumes
Public Reaction	Corporate veil	Public scrutiny
Subsidiaries	Remain in Corporate Family (Corporate Veil)	Confused

The Role of Shareholders

The differences in the role of shareholder of a private sector as compared to a Crown corporation are significant. The similarities and commonalities are not. A private sector corporation can usually count on shareholders' acquiescence to company activities: the shareholders are interested in only one main benefit - receipts of financial return. In turn, such an expectation implicitly assumes, that the company will survive and perhaps even grow. The shareholder is, or perhaps wishes to be ignorant of how the company operates including any "commercial practices" (or even 'dirty tricks') the company may follow. The government, however, as the shareholder in Crown corporations must direct so as to be seen to be responding to its constituents, the public. This means that not only is the corporation doing what the Minister (and, presumably through the Minister, the Crown) wants but that it also does it in a manner acceptable to the electorate. "Dirty Tricks" may be unacceptable if, thereby, a Canadian company is seen to have been disadvantaged. Thus the roles of the shareholders are fundamentally different. In a private sector corporation, the shareholders are usually passive and satisfied to receive, or expect to receive, their benefits. In government Crown corporations the shareholder has to be active, initially, at least, to meet its program priorities towards the electorate. Once the corporation is meeting clearly stated objectives as required, then, of course, the shareholders can also relax into a quiescent state. Such is rarely the case, however. Furthermore, while in a private sector corporation the shareholder is accountable for his investment only to himself, the Minister, as shareholder of the Crown corporation is accountable not to himself, but both to Parliament and, beyond Parliament, the electorate. However, these two

differences are not recognized or taken into account by proponents of incorporation using the CBCA.

The relationship between a shareholder of a private sector corporation and his corporation, (figure II) permits the shareholder to experience and have some influence on the many factors which impact on corporate strategies. The influence of an individual shareholder may be negligible and the corporation may be forced to comply with direction of shareholders only if a sufficient number of shareholders agree on a common approach. Such a common approach is itself only derived as a result of the interaction of a complex set of factors. In the case of the Crown corporation, however, all the influences which infuence a corporation's strategies are concentrated on the single shareholder. The Minister is not only the shareholder in trust, he is also, through his position as a member of the government, the consumer and the financial market, and for these corporations there is no competition in a commercial sense. Clearly, therefore the shareholder's influence on a corporation in the two cases is fundamentally different.

The Objectives

A corporation incorporated under CBCA has virtually unlimited powers within the law, unless its powers are specifically restrained in any way by a unanimous shareholders agreement. The concept of public accountability and public purpose predicates that a Crown corporation which is not subject to specific legislative directives needs to be subject to a unanimous shareholders agreement. But if, as is the case, the unanimous shareholder's agreement was

approved by Order in Council and not tabled in Parliament, Parliament had no say in the powers of the corporation even though accountability for the corporation to Parliament exists in theory. It is also worth noting that even though constrained by a unanimous shareholders agreement, entities uncorporated under CBCA still retain powers wider than the department which reports to the same Minister, and thus raise questions about the mechanism of public accountability.

A unanimous shareholders agreement defines the powers of the directors of a corporation and transfers the duties and liabilities to the shareholder who is party to the agreement. In a private sector corporation, the shareholder is himself then both responsible for management which in turn is accountable to him. In effect he takes or the responsibility for achieving objectives and meeting his expectations. Given the expectations of the shareholder, and the environment in which the corporations exists, no radical departures from accepted and recognized practices need be expected when such an agreement is made. In the case of the Crown corporations discussed earlier, unanimous shareholder agreements exist in the form of management agreements, and transfer management responsibilities to the apppropriate Minister as designated by Order in Council. It follows that, except for the corporate structure beneath him, there is little difference between his position as Minister excercising control of his department and his position as shareholder exercising control of the corporation by his unanimous shareholders agreement. However there are formal procedures of Ministerial accountability to Parliament for the Department, which are not always applied to the corporations. While the unanimous shareholder's agreement in the case of a private sector corporation maintains the principle of assigning accountability with responsibility, its

application in the case of a Crown corporation assigns responsibility but not always the same degree of accountability.

Accountability

There are inconsistencies because, although incorporated under the CBCA, Crown corporations have characteristics different from other corporations so incorporated which differences are not always understood by the environment in which the corporations exist. In turn, such lack of understanding hinders the possibility of determining accountability because as yet, there are no generally accepted criteria.

The criteria for judging accountability in a private sector corporation are contained in the corporation's audited financial reports, where the company reports to the shareholders regarding the financial performance, and the auditor gives his opinion that the information has been developed in accordance with generally accepted accounting principles (ie. the reader can believe what he reads). Such reports and opinion provide a basis for the development of expectations of shareholders and creditors.

The auditing standards which have been established for private sector corporations are based on experience and theory, and are understood by the business community. This is, however, not the case when the auditor is required to attest to reports, the purposes and recipients of which differ profoundly from those with which he is familiar. This difficulty is increased when the actions and processes which the report reflect do not conform to the actions and processes for which the criteria were established.

The actions and processes by which to ensure public accountability as defined by Parliament are largely influenced and some are governed by the Financial Administration Act. The requirements of that act are elaborated in a series of regulations, which constitute a tangled web of confusion to those unfamiliar with the legislation. Adherence to these regulations involves conforming to political and bureaucratic procedures which can delay or even subvert the purposes of commercial operations. It is a process from which a normal CBCA incorporated entity is exempt. The Crown corporation effectively gets exemption from these requirements either if it is not made subject to the Act or if public servants are lax in applying its regulations to the corporation. At the same time the impact of adherence to the regulations on the financial performance of the corporation is difficult to measure and thus may distort the true picture of the corporation's results.

Other distortions occur as a result of the corporation's unique government status in the business world. These distortions are sufficiently significant to raise the question whether audit standards for commercial enterprises are adequate as standards for Crown corporations.

For example, Canadair's continued operation was stated to be to maintain or even rebuild Canadian competence in the air industry and to provide employment in an area of Montreal. In auditing the financial statements of Canadair, the auditor is attesting to a traditional financial report which would indicate massive financial losses. Any reader would probably deduce that the future of the corporation was , to say the least, uncertain. Yet the auditor and the reader, knowing Canadair's situation, also know that the corporation will

continue as long as the government continues to provide financial support. However, Governments, government priorities and programs change, often at very short notice (e.g. the Avro Arrow project). Under such circumstances, even taking business risk into account the conclusions a shareholder can draw from an audited report from a private sector perspective, would have to be inconclusive and insufficient to provide a certainty for the future. Paradoxically, therefore, the auditors' statements designed to permit deduction of a conclusion about the corporations' soundness can not do so, even though it is prepared on a sound professional basis. The paradox surfaces because the commercial criteria by which the auditor reports and by which the reports are generally judged are insufficient to cover the Crown corporation's case, even though the Crown corporation has, by its method of incorporation been given commercial guise.

Funding

Even if standards could be developed by which to adequately report on a crown company such as Canadair, another major difference between the 'normal' CBCA corporation and the 'Crown' CBCA corporations becomes evident.

A corporation incorporated under the CBCA is normally independently financially liable operating under rules well understood by the entrepeneurial environment. A Crown corporation incorporated under CBCA is usually neither independent nor financially liable and operates under very different rules.

Most of the CBCA Crown corporations own property obtained through government funding (e.g. Harbourfront) or manage property on behalf of the

government (e.g. Canada Lands Company subsidies). The proceeds which accrue from disposal of such property may accrue to the corporation or, when judged to be moneys due to the Crown, have to be deposited with the Consolidated Revenue Fund. When the proceeds arising from the sale of property have to be deposited in the CRF rather than with the corporation disposing of the asset, the flexibility which a public sector corporation enjoys of raising funds cutting losses through disposal of assets is not freely available to a Crown corporation.

In the absence of legislation giving a Crown corporation the right to borrow, the right to borrow is governed by the Financial Administration Act, which declares that "money borrowed and interest thereon" by, or on behalf of, Her Majesty is a charge on the Consolidated Revenue Fund and is thus subject to parliamentary control. Thus Crown corporations incorporated under CBCA, for which no legislative authority to borrow exists, must seek parliamentary approval so to do. While preserving parliamentary control, the use of Parliament for debt financing results in isolating Crown-owned corporations from the discipline of the markets that applies to private sector corporations and , because of the processes involved, delays the corporation's ready access to funds thereby reducing entrepreneured flexibility. On the other hand, the debt is now guaranteed by the crown, reducing somewhat the discipline of repayment to which a normal corporation is subject. There is also a general impact on "responsible government" since government accounting procedures now in in force exclude Crown corporation debts from the Public Accounts of Canada, and as stated by the Auditor General in 1983, are thereby misleading by understating the governments' liability.

Section 11 of the Financial Administration Act requires all moneys paid to Her majesty must be paid into the Consolidated Revenue Fund. Thus several of the Crown corporations have not been able to retain their operating revenues. To do so would require parliamentary approval. Accordingly, yet a further flexibility available to the corporate entity is restrained.

By scheduling a corporation under the FAA, the government applies the full rigours of that Act to the corporation, unless there is specific legislation to the contrary. As a result, a scheduled corporation's request for funds must follow and may have to compete for a place in the queue of projects which, by regulation, need to be approved at various levels of the bureaucracy, including the ministerial level. Once approved, funds are even then only to be released when the corporation, in the opinion of the Minister, really needs them. If delay is experienced, the corporation's flexibility to operate may be severely curtailed, and may not differ, in effect, from the very department which it parallels. That is not to say that a normal commercial enterprise is never subject to delays in the quest for funds, it is merely to say that for the Crown corporation there are likely to be more instances of and lengthier delays.

Agency Status

Under the CBCA, a corporation whose shares are wholly owned by the Crown has the status of being an agent of Her Majesty, unless specifically exempted by legislation. For Crown corporations currently incorporated under the CBCA there is no exempting legislation.

While there is some discussion about the precise meaning of agency status there is general agreement on some of the implications. Clearly, as an agent, a Crown corporation cannot be entirely independent. A review of the legal implications of agent status indicates that corporations acting within their mandates as agents of the Crown generally enjoy the same prerogatives and immunities as the Crown itself. At the same time, while acting within the limits of the agency, such corporations can enter into agreements with third parties and in so doing bind the Crown.

Public Reaction

But while immune to several federal statutes, the Crown corporation is not sheltered from public reaction to its activities in the same way as a private sector corporation may be. The activities of a private sector corporation, even if they are ethically doubtful commercial practices, generally do not attract much public attention but if any does develop, the use of the corporate veil and a carefully conducted public relations campaign can usually help the matter die down. In some cases litigation may ensue and a financial settlement is reached. Rarely will corporate actions make history - but when they do the magnitude of the error warrants preserving it for posterity.

In the public domain, even instances of minor corporate activities may give rise to public outcry and major public discussion. The defence is taken up on behalf of the Crown corporation by the appropriate Minister who, even though he or she is "only the shareholder" is expected to take on full responsibility before Parliament for the sins of omission or commission of the corporations for which

he or she is accountable. It is a surprising choice to make - since responsible government requires that he or she shoulder the burden. Often, however, the Minister will only answer questions and will not take responsibility for administrative actions.

Provincial Taxes

Federal agent Crown corporations are also generally immune from the application of provincial legislation. In Quebec, federal agent Crown corporations are immune from the application of the Chartre de la langue française. In another case, Eldorado Nuclear Ltd. was held by the Court to be immune from the charges laid against it under the Ontario Water Resources Act.

Pursuant to Section 125 of the British North America Act, the federal Crown and Her agents are immune from provincial property taxes. This is a privilege not available to a commercial company.

Security

Security for the corporations, as agents of Her Majesty, is available through a $1.00 vote in Parliament - a less expensive way to buy insurance than actually having to pay for it.

It would seem from the comparison that Crown corporations conform more closely to departmental than to commercial entities, a view stated earlier by Glassco. Their differences from a commercial entity, as pointed out by

Lambert are profound. While certain operational advantages exist for a Crown corporation, the basic disadvantages which result from compliance with the FAA, that is the legislative restraints on funding presents an underlying contradiction in choosing the CBCA/FAA corporate entity for achieving public purposes.

The contradiction is clear. Entrepreneurial flexibility exists for a corporation incorporated under the CBCA because the corporation has the freedom to operate without legislative restraints. To achieve public accountability as defined by Parliament requires either specific legislation to the corporation, or adding the corporation to a schedule of the FAA. Compliance with the FAA entails restrictions which limit freedom to operate. Exemption from those restrictions can only be obtained by legislation. If total freedom is granted, simply by not applying the FAA to a Crown corporation, public accountability disappears. Some form of legislation is required but the principle of incorporating a corporation under the CBCA is that specific legislation can be avoided.

A complication in the structural process arises because for two of the corporations for which Ministers hold all the shares it is the subsidiaries which are active and have all the expenses. For these, it is the holding corporation which has the legal right to provide direction. This creates a barrier even between the Minister and the actions of the corporation. This structure can be short circuited and causes confusion when Ministers deal directly, even if informally, with the subsidiaries. In turn such a structure raises questions about the role of the parent corporation.

The relationship between Ministers, Parliament and the corporations begins to appear thus (figure IV):

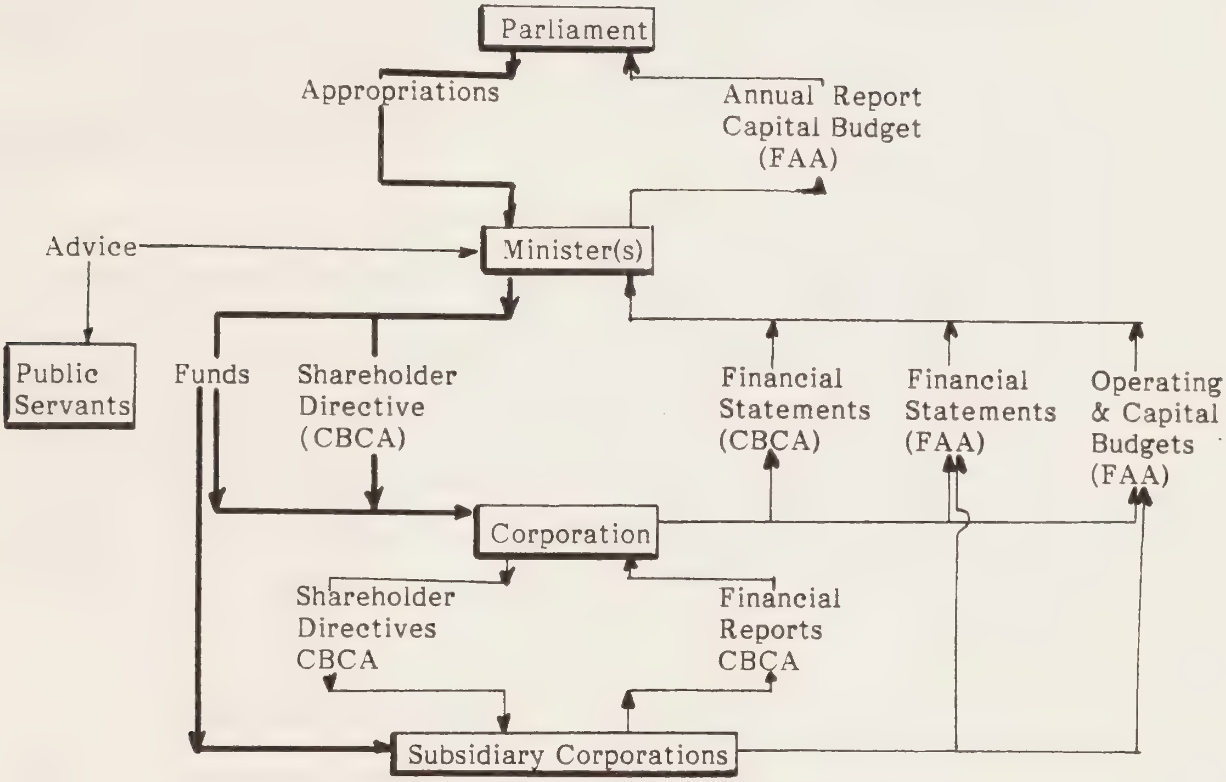

Fig IV Relationship of Crown corporations to Minister(s)

In some instances, where majority and minority shareholders exist, dual responsibilities and accountabilities have been established, whereby the subsidiary corporations report not to the major shareholder, as would be expected, but to the minority holder. In these cases the major shareholder has been directed to vote as directed by the minority shareholder who, however, does not always control the funds voted to the corporation. A careful "paper trail" is then necessary to ensure that accountability and responsilibity rest in the same area of operations. Unfortunately neither does a 'paper trail' always exist nor is there an accepted understanding of where either accountability or responsibility rest. This topsy-turvey arrangement runs counter to accepted commercial practice.

The process becomes further convoluted when public servants are appointed to positions on the corporation. Lambert and Glassco, without elaboration, both referred to the potential conflicts which can and do arise, but offered no solution by which to establish a priority.

PUBLIC PURPOSE

The use of a corporate entity to achieve public purposes rests on the concept that such purpose can be realized by initiating a strategy and implementing it to its conclusion. It's as if a train is sent up a single track line with an implicit certainty that there are no junctions, no on coming traffic, there is a track to get to the destination and sufficient fuel and maintenance to ensure continued progress, and it will arrive.

Again, the concept is simplistic since it takes no account of the realities of the public process of implementing public purpose. Of course, instances exist where indeed the public purpose is so achieved, but in fact the conflicting demands of other public activities frequently cause delays if not abandonment.

Any entity which seeks to achieve public purpose is not only subject to forces analagous to those experienced by a private sector corporation, but in addition is subject to forces, simplistically called the political process, to which a private sector corporation is not. It is largely the freedom from these forces and the freedom from having to divert resources to meet the demands these forces engender which permits an entrepreneur to retain flexibility.

- No corporation need specifically be worried by the level of unemployment, social security problems, general economic development, national defence, foreign relations, or the need to be re-elected in Parliament. Of course, in a micro cosmic way these considerations impact on the corporation, but it is not faced with having to solve them and so divert resources from its prime functions.

CONCLUSION

In the preceding paragraphs, I have discussed the practice and theory, of the use of the corporate entity incorporated under CBCA and made subject to the FAA as a vehicle for achieving public purposes. I have also analysed the similarities and dissimilarities between the Crown corporation and a commercial entity. My conclusions are:

- If responsible government and public accountability are to exist for Crown corporations, Parliament, to which the government is accountable, and not the government, must have control over the creation, the establishment of powers of and funding arrangements for such corporations. In the case of the Crown corporations presently incorporated under the CBCA, this has not happened.

- The joining of entrepreneurial flexibility with public purpose and accountability is complex. The implications of the complexity have not been adequately considered.

- The CBCA regulates the activities of an otherwise unrestricted business entity and reflects the relationship of a corporation to its shareholder and its creditors, basically relying on long-established market forces to provide additional disciplinary influences. Operation under such conditions is generally understood to mean entrepreneurial flexibility. On the other hand, if public accountability as presently established by Parliament is to be maintained, Crown corporations must comply with the FAA. The FAA however, contains restrictions which limit entrepreneural flexibility, and, total exemption from which can only be obtained by legislation.

- The use of a unanimous shareholders agreement is logical in the case of a private sector corporation because it does not disturb market influences. The agreement is not appropriate in the case of a Crown corporation because, while possbily ensuring a degree of public accountability, it displaces market influences and so distorts entrepreneurial flexibility. In effect, it subjects the corporation to the direct influences of government wishes.

- Compliance with CBCA alone does not preserve public accountability.

- Compliance with the FAA does not preserve entrepreneurial flexibility.

- There is insufficient commonality or similarity between corporations complying with either CBCA or the FAA alone to use business criteria to provide assurance that both public accountability is respected and entrepeneurial flexibility exists.

The overall conclusion that the requirements of public accountability are not met by the legislative framework established by the CBCA supports what an alternative approach might offer. Based on the above, a practical approach might be to develop new legislation which might incorporate some of the features now found in the CBCA and the FAA and some which would remain to be drafted.

Such legislation might require, as a minimum:

- Approval by Parliament of the establishment of a new Crown-owned corporation including new subsidiaries of existing corporations.

- Approval by Parliament of the powers to which the corporation is restricted.

- Approval by Parliament of the right of the corporation to:

    (a) spend revenues
    (b) dispose of assets in accordance with given guidelines
    (c) receive appropriations, where approved, at the beginning of the year.

- Tabling of capital budgets and annual Reports in Parliament, with an opportunity for Parliament to debate matters arising therefrom.

- Defining the appropriate Ministers' accountability on behalf of the Governor in Council, to Parliament and their relationship to the corporation as the shareholders.

- Define the corporation's powers as, or exemption from agent status.

- Define the corporation's exemption (if any) from federal or statutes, government and regulations with respect to conditions of employment, contracting, and access to funding.

- Establish some standards or guidance by which auditing of such a corporation can take place. (As an example, the portion of the auditor general as stated in his 1982 report could be used for reference).

Examination of the present Government Companies Operations Act suggets that it no longer serves a useful purpose. A revised GCOA could serve as a vehicle for achieving the above.

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